

OPEN MEETING ITEM  
ORIGINAL



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COMMISSIONERS  
JEFF HATCH-MILLER - Chairman  
WILLIAM A. MUNDELL  
MIKE GLEASON  
KRISTIN K. MAYES  
BARRY WONG



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22

ARIZONA CORPORATION COMMISSION

2006 OCT -3 P 4: 48

DATE: October 3, 2006

AZ CORP COMMISSION  
DOCUMENT CONTROL

DOCKET NO: W-02124A-06-0379

TO ALL PARTIES:

Enclosed please find the recommendation of Chief Administrative Law Judge Lyn Farmer. The recommendation has been filed in the form of an Opinion and Order on:

DESERT HILLS WATER COMPANY

(ORDER TO SHOW CAUSE)

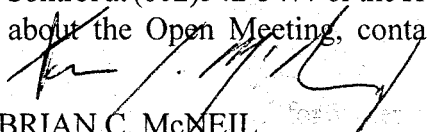
Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00 p.m.** on or before:

OCTOBER 12, 2006

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

OCTOBER 17 AND 18, 2006

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250. For more information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

  
BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

Arizona Corporation Commission  
DOCKETED

OCT -3 2006

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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 **COMMISSIONERS**

3 JEFF HATCH-MILLER, Chairman  
4 WILLIAM A. MUNDELL  
5 MIKE GLEASON  
6 KRISTIN K. MAYES  
7 BARRY WONG

8 IN THE MATTER OF THE COMMISSION ON ITS  
9 OWN MOTION INVESTIGATING THE FAILURE  
10 OF DESERT HILLS WATER COMPANY, INC.,  
11 TO COMPLY WITH COMMISSION RULES AND  
12 REGULATIONS.

DOCKET NO. W-02124A-06-0379

DECISION NO. \_\_\_\_\_

**OPINION AND ORDER**

13 DATES OF HEARING:

August 21 and 23, 2006

14 PLACE OF HEARING:

Phoenix, Arizona

15 ADMINISTRATIVE LAW JUDGE:

Lyn Farmer

16 IN ATTENDANCE:

Jeff Hatch-Miller, Chairman  
William A. Mundell, Commissioner  
Mike Gleason, Commissioner  
Kristin K. Mayes, Commissioner  
Barry Wong, Commissioner

17 APPEARANCES:

Mr. Jay L. Shapiro, FENNEMORE CRAIG, on  
behalf of Desert Hills Water Company, Inc.;

Mr. Garry D. Hays, GALLAGHER &  
KENNEDY, on behalf of Intervenor Abbyron  
Desert Hills, LLC; and

Ms. Maureen A. Scott and Ms. Janet Wagner,  
Staff Attorneys, Legal Division, on behalf of the  
Utilities Division of the Arizona Corporation  
Commission.

22 **BY THE COMMISSION:**

23 On June 6, 2006, the Arizona Corporation Commission ("Commission") Utilities Division  
24 ("Staff") filed a Complaint and Petition for Order to Show Cause ("OSC") against Desert Hills Water  
25 Company, Inc. ("DHW" or "Company") stating that DHW violated numerous provisions of Arizona  
26 law, Commission Rules and provisions of the Arizona Revised Statutes.

27 On June 12, 2006, DHW filed a Response and Objection of Company to Staff's  
28 Recommended Form of Order.

1 On June 19, 2006, the Commission issued an OSC in Decision No. 68780.

2 On June 20, 2006, Abbyron Desert Hills, L.L.C. filed a Motion to Intervene ("Motion").

3 On June 22, 2006, Staff filed a Request for Procedural Order and proposed dates for filing  
4 testimony and hearing.

5 On June 26, 2006, counsel for DHW contacted the Hearing Division telephonically and stated  
6 agreement with Staff's proposed procedural schedule.

7 On June 26, 2006, a procedural order was issued adopting the dates agreed upon by the  
8 parties, and setting the hearing for September 13, 2006.

9 Subsequent to the setting of the hearing, numerous customers contacted the Commission  
10 requesting the hearing be conducted prior to September 13, 2006. By telephonic procedural  
11 conference held on July 7, 2006, Staff and DHW agreed that the hearing could be moved to August  
12 21, 2006.<sup>1</sup> Staff requested and DHW agreed to a 5 day discovery turn around, and DHW confirmed  
13 that it would file its Answer no later than Monday, July 10, 2006.

14 On July 10, 2006, by Procedural Order, Abbyron Desert Hills, LLC ("Abbyron") was granted  
15 intervention and the hearing was rescheduled for August 21, 2006.

16 On July 10, 2006, DHW filed an Answer to the OSC.

17 On July 21, 2006, pursuant to the Commission's Procedural Order, DHW filed an Affidavit of  
18 Publication.

19 On August 21, 2006, the hearing was held before a duly authorized Administrative Law Judge  
20 at the Commission's offices in Phoenix, Arizona. DHW, Abbyron, and Staff appeared through  
21 counsel. Witnesses testified on behalf of DHW, Staff, and Abbyron, and public comment was also  
22 taken at the commencement of the hearing.

23 On September 8, 2006, DHW, Staff, and Abbyron filed Closing Briefs, and on September 15,  
24 2006, DHW, Staff, and Abbyron filed their Reply Briefs.<sup>2</sup>

25  
26 <sup>1</sup> Staff indicated that the August 21, 2006 hearing date was possible if all other procedural dates, including the time for  
discovery responses, were timely met.

27 <sup>2</sup> On September 14, 2006, the Commission conducted a Special Open Meeting to discuss the Town of Cave Creek's  
28 ("Town") acquisition of all of DHW's stock. Although Commissioners posed questions to the Company and Town  
representatives, and took additional public comment from customers, no additional evidentiary hearings have been  
conducted.

**DISCUSSION**

Staff's Complaint alleged that DHW had violated Arizona law, Commission Orders and Commission Rules and Regulations in the following manner:

Count One: Violation of R14-2-407(A). DHW has failed to provide potable water to the customer's point of delivery, failed to process main line extensions in a timely manner and imposed a moratorium on new service connections without Commission authorization.

Count Two: Violation of R14-2-406.B.2. DHW failed to provide to applicants for main extensions the plans, specifications and cost estimates within the required 45 day timeframe allowed.

Count Three: Violation of R14-2-406(J). DHW failed to respond promptly to consumers or Commission Staff when inquiries are made regarding the processing of main line extensions and failed to provide updated information regarding pending requests by customers.

Count Four: Violation of R14-2-407(C). DHW refused service to customers by not responding in a timely manner in processing requests for main line extension and by not providing updated information regarding pending requests by customers. DHW advised customers that the refusal of service was due to a moratorium on the installation of new meters, however, no Commission approved moratorium existed. Customers of DHW have experienced low pressure and water outages and have had difficulty contacting DHW and getting a response. DHW has failed to communicate with and supply its customers with a satisfactory and continuous level of service.

Count Five: Violation of R14-2-411(A)(2). DHW has failed to make a full and prompt investigation of all service complaints made by its customers, either directly or through the Commission. DHW has failed to report the findings of its investigation, if any, to the Commission. DHW has not responded within five working days to informal Commission complaints.

Count Six: Violation of A.R.S. 40-321(B). DHW has failed to provide service to customers who have made a proper demand and tender of rates.

1        County Seven: Violation of A.R.S. § 40-321(A). DHW's refusal to provide service without a  
2        Commission approved moratorium in effect and its unreasonable delays in processing  
3        requests for service (approximately 9 months to one year) has caused it to provide "unjust,  
4        unreasonable, . . . improper, inadequate or insufficient" service.

5        Count Eight: Violation of Obligation to Serve. DHW failed to provide service to multiple  
6        customers who had made lawful requests for service. DHW violated its obligation to provide  
7        service to customers within its certificated area.

8        Count Nine: Article XV, § 3 Arizona Constitution. The Commission may enter "orders for  
9        the convenience, comfort, and safety, and preservation of the health" of the customers of a  
10       public service corporation. This includes the option to appoint an interim manager of DHW's  
11       water system.

12       Staff presented testimony from Steve Olea, Assistant Director of the Utilities Division. Mr.  
13       Olea testified that for over a year the Company has been unable to provide adequate service to  
14       customers in its service territory, and has not met its obligations as a certificated public service  
15       corporation. He testified that beginning in July 2005, Staff began receiving informal complaints from  
16       prospective customers alleging that the Company had refused to provide service. The prospective  
17       customers told Staff that DHW had advised them that a moratorium on new service connections was  
18       in effect. Upon reviewing Commission records, Staff determined that no Commission approved  
19       moratorium was in effect, meaning the Company was still required to accept and process any main  
20       extension requests. Staff did not receive any main line extension agreements for review and approval  
21       until September, 2005. After the main line extensions had been entered into by the Company, Staff  
22       began receiving complaints that delays were occurring and that the Company was not communicating  
23       with the customers on the status of the projects.

24       According to Staff, the Company's primary problem is that it has not kept up with the growth  
25       in its service area. Staff requested on two occasions that the Company provide Staff with a remedial  
26       plan to address its water supply problem, but the Company never responded. (Olea Direct, p 4) as

27       Staff witness Olea testified that one area is being impacted more than others, and that due to a  
28       design flaw, 189 customers living between approximately 16<sup>th</sup> and 24<sup>th</sup> streets, the "one-square mile

1 area", are without water or have inadequate pressure for several hours every morning. (Olea Direct  
2 testimony, p 6) Substantial public comment came from those customers who expressed extreme  
3 frustration and concerns about the continuing lack of water. Staff believes that DHW, with the  
4 emergency connections with Cave Creek Water Company and the Anthem system, has adequate  
5 water pressure to serve the customers, but is unable to get the water to the area at a sufficient  
6 pressure. Staff believes that instead of planning for the growth, DHW designed its system as if the  
7 emergency connection with Cave Creek Water Company was a permanent source of water. DHW is  
8 reconfiguring its system, installing the Cloud Road Booster Station, to provide service to those  
9 customers from its own wells, or from the Anthem system if that becomes a permanent, non-  
10 emergency water source. Mr. Kolman testified that the County will put the Cloud Road project to the  
11 head of the list when the Company files its request for approval of construction. (Tr. Vol. I p 102)

12 Staff presented evidence that the need for additional wells, booster pumps and storage  
13 facilities to keep up with growth was known by the Company as early as 1995. According to Staff,  
14 prior to the current crisis, DHW was approached by Cave Creek Water Company with the idea of  
15 installing an in line booster pump as a temporary fix for the lack of pressure in the one-square mile  
16 area, but apparently DHW turned it down because Cave Creek Water Company asked DHW to pay  
17 the cost of the pump estimated at \$25,000.

18 On June 28, 2006, Maricopa County Environmental Services Department ("MCESD") issued  
19 a Letter of Outstanding Violations that listed several incidences of inadequate water pressure. Mr.  
20 Olea testified that these conditions are even more serious because even with the emergency  
21 supplemental water from two neighboring utilities, the Company cannot adequately supply all of its  
22 customers with water. Mr. John Kolman, program manager for the drinking water and solid waste  
23 programs with the MCESD, testified at the hearing that DHW was not in compliance with county  
24 regulations. Mr. Kolman testified that DHW is out of compliance due to its failure to provide 20 psi  
25 in all parts of these system at all times, and for its failure to have sufficient 24-hour storage demand.  
26 (Tr. Vol. I, p 91) He indicated that these are health and safety concerns, and that the county has set  
27 up pressure recorders and started bacteriological testing and taking chlorine readings. Mr. Kolman  
28 testified that the samples have not shown bacteriological issues, but that the chlorine readings were

1 lower than they would like to see. (Tr. Vol. Ipp 97-98) Mr. Kolman testified that the Company did  
2 not respond to the letter of outstanding violation within the 30 days allowed. (Tr. Vol. I, p 94) Mr.  
3 Kolman also testified that a county moratorium on approvals for water line extensions and new  
4 subdivisions for DHW has been put in place.

5 Mr. Bradley Morton, Public Utilities Consumer Analyst II, testified about the Company's  
6 failure to appropriately respond to and process customer complaints. He testified that between  
7 January 1, 2005 and July 20, 2006, 155 complaints and inquiries regarding low water pressure and  
8 outage problems had been filed with the Commission, and four formal complaints had been filed with  
9 the Commission. Mr. Morton testified that Staff had met with the Company on more than one  
10 occasion to discuss Staff's concerns about DHW's performance of its duties as a public service  
11 corporation. (Morton Direct p 4) Mr. Morton testified that the Company's responses to Staff have  
12 been less than prompt and generally failed to provide the information requested by Staff. Mr. Morton  
13 indicated that the Company's responses to its customers' inquiries were likewise not timely or  
14 responsive, as documented in the complaint records attached to his testimony. Mr. Morton testified  
15 that during a site visit to the Company, it was clear to Staff that the Company did not maintain a  
16 tracking record of main line extensions. (Morton Direct testimony p 9)

17 Abbyron presented testimony of Greg Wallace, hydrologist at Errol L. Montgomery and  
18 Associates. Mr. Wallace testified that Errol L. Montgomery and Associates was retained by Abbyron  
19 to conduct hydrological surveys on a portion of real property in DHW's certificated area in order to  
20 demonstrate an Assured Water Supply and to drill a new service well. Abbyron bought 100 acres of  
21 land located in the Desert Hills area from the State Land Department at auction and plans to develop  
22 a 73 lot subdivision known as Cielo Grande at Desert Hills ("Cielo Grande"). Abbyron proposes to  
23 add a new service well and tank to the DHW system that would support Cielo Grande as well as add  
24 excess production to the system. (Wallace Direct p 2) Abbyron suggests that the Commission adopt  
25 a mechanism for granting a variance to the moratorium when an entity provides a proven water  
26 source, similar to the mechanism the Commission adopted in Decision No. 65435 (December 9,  
27 2002) for Pine Water Company, Inc. In that Decision, the Commission required that the new water  
28 source meet an established minimum gallons per minute ("GPM") for each residential equivalent unit

1 ("REU") that would be connected to the new main, and required the utility to pay for any portion of  
2 the new water source that was in excess of that minimum GPM per REU. In his testimony at hearing,  
3 Mr. Olea said that if such a variance mechanism were established for DHW, the appropriate GPM  
4 amount would be 1.2 gallons per minute per lot, for a residential subdivision. (Tr. Vol. I p 177)  
5 Further, Mr. Olea testified that since DHW has a hook-up fee, it would only collect that amount from  
6 the developer, and not the portion of the new water source that was in excess of the minimum GPM  
7 per REU. (Tr. p 179)

8 The Company's vice president, Mary Beth Rowland, testified that the Company "accepts  
9 responsibility for solving the problems we are experiencing serving roughly one square mile of our  
10 service area." (Tr. Vol. II p 333)

11 The Company has been relying on completion of the Cloud Road booster station to resolve  
12 the pressure problem to the one square mile area. Ms. Rowland stated that Mr. Olea was "correct that  
13 the booster station is not a long-term solution without additional long-term water supplies. . . . We are  
14 committed to securing additional permanent supplies by April 1, 2007." (Tr. Vol. II p 334)

15 Ms. Rowland agreed that the Company: had failed to consistently deliver water to customers;  
16 has failed to process main line extensions in a timely manner; had imposed a moratorium on new  
17 service connections without Commission authorization; had failed to provide applications for main  
18 extension to plan specification and cost estimate within the required 45-day time frame provided in  
19 ACC Rule 14-2-406(b)(2); had until recently, failed to respond promptly to consumers and  
20 Commission Staff inquiries regarding the processing of main line extensions; has failed to provide  
21 updated information regarding pending requests by customers; has customers that have experienced  
22 low pressure and water outages and have had difficulty contacting DHW and getting a response in a  
23 timely manner; had failed to respond to informal Commission complaints within five working days;  
24 and had multiple customers who have made a lawful request for service and have failed to receive the  
25 service requested. (Tr. Vol. pp 464-466)

26 At hearing, DHW's witness testified that the Company is ready to accept an order from the  
27 Commission that: 1) sets a deadline of Friday, September 29, 2006 for the Company to seek MCESD  
28 Approval of Construction of the Cloud Road booster station: 2) sets a deadline of December 31, 2006



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1 for MCESD compliance; 3) sets a deadline of April 1, 2007, for the Company to demonstrate it has  
2 permanent water supplies to adequately serve its customers; 4) imposes a moratorium on new  
3 connections until such time as the Commission has determined that the Company has obtained  
4 permanent water supplies to serve its customers; 5) requires that a Company website be established  
5 by October 31, 2006; requires Desert Hills Water company to credit back the monthly minimum  
6 charges for water services paid by the 189 customers experiencing service interruptions from June  
7 2006 until the Cloud Road booster station is operational. (Exhibit DH-2) The Company also  
8 supports the requested variance for Abbyron as long as the water is actually available. (Tr. Vol. II pp  
9 336-7) The Company agreed that it would accept the consequences of not meeting the deadlines  
10 recommended by Mr. Olea, including the higher assessment of fines and the appointment of an  
11 interim manager. (Tr. Vol. II pp 378-9)

## 12 RECOMMENDATIONS OF THE PARTIES

### 13 Non-Monetary recommendations

14 Staff's revised recommendations are set out in its Initial Brief, and include both monetary and  
15 non-monetary recommendations. The non-monetary recommendations include:

- 16 • Implementation of a moratorium on new connections in DHW's service area, with the  
17 ability for parties to apply for a variance as recommended by Staff and Abbyron;
- 18 • Implementation of a series of critical event deadlines, which the Company must meet  
19 in the future or face the appointment of an interim manager, including a deadline of  
20 September 29, 2006 for Environmental Services' approval of construction of the  
21 Cloud Road Booster Station; a deadline of December 31, 2006 for Maricopa County  
22 Compliance; and a deadline of April 1, 2007 for the Company to demonstrate  
23 adequate, long-term permanent water supplies;
- 24 • Requirement that the Company submit to the Commission within 60 days of the  
25 decision in this matter, a detailed remedial plan, with supporting information including  
26 contracts and reports from experts when available, that the Company is on track to  
27 meet the April 1, 2007 deadline. The plan should include important milestones agreed  
28 upon by the Company and Staff, and should include all alternatives being explored;

- Requirement that the Company include measures in its remedial plan to address the problems it is having with communicating with its customers and with Staff. Those measures include a web-site up and operational for its customers by the end of October, 2006; email to customers with updates on water supply problems and progress in finding solutions; increase in staff and office hours as needed; making itself available to Staff on a daily basis to give updates until the situation is resolved; implementation of a tracking mechanism for main extension requests and logs documenting when requests are received and actions taken; and Staff's review of Company communications to its customers concerning its water supply problems and their resolution;
- Requirement that the Company give customers in the One-Square Mile Area an adjustment for their rates for the inadequate service they have received over the past months;
- Include a provision to allow for variances of the moratorium under appropriate circumstances as recommended by Abbyron, which would allow entities to bring a new water source to the system. If the Commission approves a variance to the moratorium that is similar to the one in the Pine Water Company matter, the number used in residential subdivisions would be 1.2 gpm per lot.

Staff did not recommend that the Commission appoint an interim manager at this time, but recommended that the Commission keep the option open in the event that the Company was not in compliance with MCESD by the end of the year or if the Company had not installed all additional water sources necessary to provide adequate and proper water service, by April 1, 2007.

In its Reply Brief, the Company states that it agrees with all but one of Staff's proposed non-monetary remedies. Those agreed to include:

- 1) a moratorium on new connections in DHW's service area, provided that parties who meet certain criteria be allowed to apply for a variance;
- 2) Establishment of a series of deadlines, including filing an application to secure MCESD's approval of construction for the Cloud Road Booster Station by September

29, 2006; securing Maricopa County compliance by December 31, 2006; and demonstration of adequate long-term permanent water supplies by April 1, 2007;

On 3) Submittal of a detailed remedial plan with supporting information to demonstrate that the Company is on track to meet the April 1, 2007 deadline;

4) Include measures in the remedial plan to address past communication problems between customers and Company staff, including a website, increase in staff, tracking of main extension agreements and customer complaints;

5) Provide customers within the one-square mile area a retroactive adjustment for rates for inadequate service since June, 2006, until the Cloud Road Booster pump is complete and operational; and;

6) Include a provision in the Order allowing variances of the moratorium under appropriate circumstances as urged by Abbyron.

The Company does not believe that the appointment of an interim manager is appropriate because it believes that it has or is in the process of taking steps to address the issues identified, including working "diligently to complete the Cloud Road booster station"; securing an extension of its temporary supply agreement with Arizona-American; hiring a "well-respected hydrologist to find additional water supplies in the Company's CC&N"; starting negotiations with the developer of the Cielo Grande subdivision to acquire any excess water; adding staff and seeking to hire "additional, qualified staff to assist with serving the needs of customers." (DHW Closing Brief p 5)

In its Reply Brief, the Company states that it does not agree with the Staff recommendation that failure to meet the deadlines may result in the appointment of an interim manager and asserts that what remains for the Commission to determine is what is the appropriate monetary sanction, if any, if DHW fails to meet the deadlines.<sup>3</sup>

#### Monetary recommendations

In his prefiled testimony, Mr. Olea recommended the Commission impose a fine of \$500,000,

<sup>3</sup> Although in its Reply Brief, DHW states in a footnote that "[b]y filing this Reply Brief, the Company is not agreeing that the Commission retained jurisdiction over it after its stock was acquired by the Town." and that the testimony of Mary Beth Rowland is now "moot", the testimony remains the only sworn testimony by the Company in response to the OSC, and remains binding on the Company. See testimony of Ms. Rowland TR Vol II pp 378-379.

1 but also recommended that in order to ensure that the Company accomplishes the goals of providing  
2 proper and adequate service, that a positive incentive to promptly comply with not only Commission  
3 requirements but also MCESD requirements should be put into place. Staff recommended that if the  
4 Company is providing proper and adequate service to the one square mile area by August 4, 2006, the  
5 fine should be reduced; if DHW is in full compliance with the MCESD by December 31, 2006,  
6 another reduction would be appropriate; and the fine could be reduced even further if DHW has  
7 sufficient permanent water sources to adequately and properly serve its certificate area by April 1,  
8 2007. Mr. Olea testified that the amount of the fine was based upon a review of the Company's  
9 Annual Reports which Staff found indicated the Company had been earning a profit of approximately  
10 \$250,000 per year for the last four years, and based upon average cash on hand of \$300,000.

11 In its Initial Closing Brief, Staff argues that the Commission should impose a monetary fine  
12 that can be adjusted based upon DHW's efforts to remedy the deficiencies that plague its operations.  
13 Staff's recommendation involves dates for the completion of three objectives: 1) completion of the  
14 Cloud Road Booster Station by September 29, 2006; 2) compliance with Maricopa County by  
15 December 31, 2006; and 3) acquisition of sufficient additional water source(s) by April 1, 2007.

16 Mr. Olea suggested a \$500,000 fine which would be reduced by \$20,000 for every day in  
17 advance of September 29, 2006 that the Cloud Road Booster Station is completed, and be increased  
18 by \$20,000 for every day after September 29, 2006 that the project is delayed, up to a maximum of  
19 \$1 million. If DHW is in full compliance with Maricopa County by December 31, 2006, the fine  
20 could be reduced by \$100,000, and by another \$100,000 if the Company has sufficient additional  
21 water source(s) by April 1, 2007. Staff recommends that DHW immediately pay \$50,000,  
22 irrespective of its success in meeting the objectives. Staff calculated that the Commission could fine  
23 DHW \$1,558,000 or higher, but recognizes that the Company will need funds to remedy its  
24 deficiencies and therefore believes it is appropriate to balance the gravity of the Company's  
25 violations against the goal of creating an incentive for the Company to remedy the violations.

26 Although in its testimony at the hearing, the Company agreed that refunds to customers and  
27 fines imposed by the Commission would be appropriate, in its Closing Brief, the Company requests  
28 that in lieu of any fine, it be only ordered to "credit back the monthly minimum charges for water

1 services paid by the 189 customers experiencing service interruptions from June 2006 until the Cloud  
 2 Road booster station is operational. This would directly compensate those that have suffered the  
 3 results of the violations the Company has admitted to in this proceeding. It would also ensure that the  
 4 Company is able to continue operating in a manner that is financially viable.” (Company’s Closing  
 5 Brief pp 8-9)

### 6 ANALYSIS

7 In its Brief, Staff places the 8 counts into three categories:

- 8 1) Those related to the Company’s failure to provide adequate service to existing customers  
 9 (Counts 1, 4, 8);
- 10 2) Those related to the Company’s failure to promptly and adequately process main  
 11 extension requests (Counts 1, 2, 3, 4, 6, 7, 8); and
- 12 3) Those related to the Company’s failure to promptly respond to customer complaints and  
 13 Staff inquiries (Counts 3, 4, 5).

14 In its Closing Brief, the Company’s response to Counts 1, 4, 5, 6, 7, 8 admitted that “service  
 15 to roughly 189 customers in an approximately one-square mile of its CC&N has not been consistently  
 16 provided at adequate pressure, which has resulted in a number of temporary outages in that area  
 17 during certain times of the day since early June, 2006. TR at 464 (Rowland). There is no evidence  
 18 that such problems have occurred elsewhere in the Company’s CC&N.” (Company’s Closing Brief,  
 19 pp 2-4)

20 In response to Counts 2 and 3, the Company responded that it had “admitted that it failed to  
 21 timely process main extensions in its CC&N. TR at 464 (Rowland) The Company has since  
 22 processed and Staff has approved some of the outstanding main extension agreements. . . . Several  
 23 others are in an informal stage awaiting the outcome of both this proceeding and the Company’s  
 24 efforts to resolve the pressure problems it has experienced in a portion of its service territory.”  
 25 (Company’s Closing Brief pp 2, 3)

26 The Company has agreed that it has violated Arizona law, statutes, and Commission  
 27 regulations as alleged in the OSC. It has agreed with all of Staff’s non-monetary recommendations  
 28 except for the appointment of an interim manger upon failure to meet deadlines. We agree with

1 Staff's recommendations, including reservation of our ability to appoint an interim manager upon the  
2 nonoccurrence of the specific events by the agreed upon deadlines. Our adoption of this  
3 recommendation does not automatically mean that an interim manager will be appointed in that  
4 event, but puts the Company on notice, that depending upon the circumstances, the appointment of an  
5 interim manager may be necessary and required.

6 As to the monetary recommendations, we will require the Company to refund/credit the  
7 monthly service charge to customers living in the one-square mile area and to any nearby customer  
8 who has or can demonstrate service interruptions during the relevant timeframe. If there were other  
9 means within our jurisdiction available to compensate the customers for their inconvenience,  
10 frustration and the poor service that they received, we would be inclined to grant those also. Further,  
11 due to the serious and ongoing issues concerning water supply and service to customers, we agree  
12 with Staff that a financial penalty should be imposed upon the Company for its violations of its public  
13 service obligations, Arizona law, statutes, and Commission regulations. We agree with Staff that a  
14 sliding scale of penalties is appropriate and that an immediate fine of \$50,000 should be imposed.  
15 Further, that the \$50,000 fine should be reduced by \$2,000 for each day the Cloud Road Booster  
16 Station is operational prior to September 29, 2006. Finally, we believe that the penalty for not  
17 complying with the December 31, 2006 deadline should be \$200,000; and the fine for not complying  
18 with the April 1, 2007 deadline should be \$250,000.

19 \* \* \* \* \*  
20 Having considered the entire record herein and being fully advised in the premises, the  
21 Commission finds, concludes, and orders that:

### 22 FINDINGS OF FACT

- 23 1. Pursuant to authority granted by the Commission, DHW is an Arizona corporation  
24 engaged in the business of providing water service in Maricopa County, Arizona.
- 25 2. On April 5, 1971, in Decision No. 41279, DHW was granted a Certificate of  
26 Convenience and Necessity ("Certificate") to provide water service in Maricopa County.
- 27 3. On or about July 21, 2005, the Commission's Staff began receiving informal  
28 complaints from prospective customers seeking water service within DHW's CC&N, alleging that the

1 Company had refused to provide service.

2 4. On June 6, 2006, Staff filed an OSC stating that DHW had violated Arizona law,  
3 Commission Orders and Commission Rules and Regulations in the following manner:

4 Count One: Violation of R14-2-407(A). DHW has failed to provide potable water to the  
5 customer's point of delivery, failed to process main line extensions in a timely manner and  
6 imposed a moratorium on new service connections without Commission authorization.

7 Count Two: Violation of R14-2-406(B.2). DHW failed to provide to applicants for main  
8 extensions the plans, specifications and cost estimates within the required 45 day timeframe  
9 allowed.

10 Count Three: Violation of R14-2-406(J). DHW failed to respond promptly to consumers or  
11 Commission Staff when inquiries are made regarding the processing of main line extensions  
12 and failed to provide updated information regarding pending requests by customers.

13 Count Four: Violation of R14-2-407(C). DHW refused service to customers by not  
14 responding in a timely manner in processing requests for main line extension and by not  
15 providing updated information regarding pending requests by customers. DHW advised  
16 customers that the refusal of service was due to a moratorium on the installation of new  
17 meters, however, no Commission approved moratorium existed. Customers of DHW have  
18 experienced low pressure and water outages and have had difficulty contacting DHW and  
19 getting a response. DHW has failed to communicate with and supply its customers with a  
20 satisfactory and continuous level of service.

21 Count Five: Violation of R14-2-411(A)(2). DHW has failed to make a full and prompt  
22 investigation of all service complaints made by its customers, either directly or through the  
23 Commission. DHW has failed to report the findings of its investigation, if any, to the  
24 Commission. DHW has not responded within five working days to informal Commission  
25 complaints.

26 Count Six: Violation of A.R.S. 40-321(B). DHW has failed to provide service to customers  
27 who have made a proper demand and tender of rates.

28 Count Seven: Violation of A.R.S. § 40-321(A). DHW's refusal to provide service without a

1 Commission approved moratorium in effect and its unreasonable delays in processing  
2 requests for service (approximately 9 months to one year) has caused it to provide "unjust,  
3 unreasonable, . . . improper, inadequate or insufficient" service. the

4 Count Eight: Violation of Obligation to Serve. DHW failed to provide service to multiple  
5 customers who had made lawful requests for service. DHW violated its obligation to provide  
6 service to customers within its certificated area.

7 Count Nine: Article XV, § 3 Arizona Constitution. The Commission may enter "orders for  
8 the convenience, comfort, and safety, and preservation of the health" of the customers of a  
9 public service corporation. This includes the option to appoint an interim manager of DHW's  
10 water system.

11 5. On June 12, 2006, DHW filed its Response and Objection of Company to Staff's  
12 Recommended Form of Order. are.

13 6. On June 19, 2006, the Commission issued Decision No. 68780, an Order to Show  
14 Cause, which order DHW to appear and show cause why its actions do not represent a violation of  
15 A.R.S. § 40-321(A) & (B), A.A.C. R14-2-406 (J) and B.2, A.A.C. R14-2-407(A) & (C), A.A.C. R14-  
16 2-411(A)(2), and its obligations as a public service corporation; why a qualified Manager should not  
17 be appointed, as selected by Staff; why DHW should not be ordered to cooperate with and indemnify,  
18 defend and hold harmless the Manager; why the Manager should not be given the authority to  
19 explore, negotiate, and implement a long-term water supply solution for DHW; why DHW should not  
20 be required to find additional, adequate, and permanent sources of water to serve its customers; why a  
21 moratorium should not be issued on installing new water meters until further order of the  
22 Commission; why the Company should not be required to conduct more frequent testing for the  
23 presence of bacteria while the problem of dry water mains and intermittent, inadequate water pressure  
24 are present; why other relief deemed appropriate by the Commission should not be imposed; why  
25 fines should not be assessed upon DHW to the maximum extent permitted under Arizona Law.

26 7. On June 20, 2006, Abbyron filed its Motion to Intervene.

27 8. On June 22, 2006, Staff filed its Request for Procedural Order.

28 9. On June 26, 2006, a Procedural Order was issued setting the hearing to commence on



1 September 13, 2006.

2 10. On July 10, 2006, a revised Procedural Order was issued changing the hearing date to  
3 August 21, 2006, granting intervention to Abbyron, and ordering the publication of the notice of  
4 hearing.

5 11. On July 10, 2006, the Company filed its Answer.

6 12. On August 2, 2006, DHW filed a Request for Order Authorizing Substitution of  
7 Counsel.

8 13. On August 3, 2006, an Application to Withdraw as Counsel was filed by Sallquist,  
9 Drummond & O'Connor, requesting permission to withdraw as counsel to DHW in this matter.

10 14. By Procedural Order issued August 8, 2006, the Application to Withdraw and Request  
11 to Substitute Counsel were granted.

12 15. The hearing was held as scheduled on August 21 and 23, 2006. Staff presented  
13 testimony from Steven Olea, Bradley Morton, and John Kolman; Abbyron presented testimony from  
14 Greg Wallace and John Lutich; and DHW presented testimony from Mary Beth Rowland.

15 16. On August 22, 2006, Staff filed documents requested by Commissioner Mundell that  
16 were provided by Dorene Stegman.

17 17. On August 25, 30, September 5, 7, 12, and 19, 2006, Staff filed field reports on the  
18 status of the Cloud Road Booster Station.

19 18. On September 12, 19, 22, 26, and 29, 2006, the Company filed its reports on the status  
20 of the Cloud Road Booster Station and any service outages. The September 29, 2006, report stated  
21 that the Cloud Road Booster Station was operational.

22 19. On September 6, 2006, the Company filed as a late-filed exhibit, a copy of its  
23 Agreement to Extend Temporary Water Supply Agreement between DHW and Arizona-American,  
24 dated August 31, 2006. The Agreement extends the term of the Temporary Agreement from October  
25 15, 2006 until March 31, 2007, under the same terms and conditions.

26 20. On September 12, 2006, Staff filed a copy of an email regarding DHW with an Open  
27 Meeting Notice and Agenda for the Town of Cave Creek.

28 21. The Commission has received substantial public comment in the matter.

1        22. Staff witnesses' testimony supported the allegations contained in the OSC, as set forth  
2 in the Discussion and incorporated herein.

3        23. At hearing, the Company accepted responsibility for the service problems associated  
4 within the one-square mile area.

5        24. At hearing, the Company admitted that it: had failed to consistently deliver water to  
6 customers; had failed to process main line extensions in a timely manner; had imposed a moratorium  
7 on new service connections without Commission authorization; had failed to provide applications for  
8 main extension to plan specification and cost estimate within the required 45-day time frame  
9 provided in ACC Rule 14-2-406(b)(2); had until recently, failed to respond promptly to consumers  
10 and Commission Staff inquiries regarding the processing of main line extensions; had failed to  
11 provide updated information regarding pending requests by customers; has customers that have  
12 experienced low pressure and water outages and have had difficulty contacting DHW and getting a  
13 response in a timely manner; had failed to respond to informal Commission complaints within five  
14 working days; and had multiple customers who have made a lawful request for service and have  
15 failed to receive the service requested.

16        25. DHW testified that the Company is ready to accept an order from the Commission  
17 that: sets a deadline of Friday, September 29, 2006 for the Company to seek MCESD Approval of  
18 Construction of the Cloud Road booster station; sets a deadline of December 31, 2006 for MCESD  
19 compliance; sets a deadline of April 1, 2007, for the Company to demonstrate it has permanent water  
20 supplies to adequately serve its customers; imposes a moratorium on new connections until such time  
21 as the Commission has determined that the Company has obtained permanent water supplies to serve  
22 its customers; requires that a Company website be established by October 31, 2006; and requires  
23 Desert Hills Water company to credit back the monthly minimum charges for water services paid by  
24 the 189 customers experiencing service interruptions from June 2006 until the Cloud Road booster  
25 station is operational.

26        26. The Company agreed that it would accept the consequences of not meeting the  
27 deadlines recommended by Mr. Olea, including the higher assessment of fines and the appointment  
28 of an interim manager.

1        27.    Staff proposed the following non-monetary recommendations:

- 2            • Implementation of a moratorium on new connections in DHW's service area, with the
- 3            ability for parties to apply for a variance as recommended by Staff and Abbyron;
- 4            • Implementation of a series of critical event deadlines, which the Company must meet
- 5            in the future or face the appointment of an interim manager, including a deadline of
- 6            September 29, 2006 for Environmental Services' approval of construction of the
- 7            Cloud Road Booster Station; a deadline of December 31, 2006 for Maricopa County
- 8            Compliance; and a deadline of April 1, 2007 for the Company to demonstrate
- 9            adequate, long-term permanent water supplies;
- 10          • Requirement that the Company submit to the Commission within 60 days of the
- 11          decision in this matter, a detailed remedial plan, with supporting information including
- 12          contracts and reports from experts when available, that the Company is on track to
- 13          meet the April 1, 2007 deadline. The plan should include important milestones agreed
- 14          upon by the Company and Staff, and should include all alternatives being explored;
- 15          • Requirement that the Company include measures in its remedial plan to address the
- 16          problems it is having with communicating with its customers and with Staff. Those
- 17          measures include a web-site up and operational for its customers by the end of
- 18          October, 2006; email to customers with updates on water supply problems and
- 19          progress in finding solutions; increase in staff and office hours as needed; making
- 20          itself available to Staff on a daily basis to give updates until the situation is resolved;
- 21          implementation of a tracking mechanism for main extension requests and logs
- 22          documenting when requests are received and actions taken; and Staff's review of
- 23          Company communications to its customers concerning its water supply problems and
- 24          their resolution;
- 25          • Requirement that the Company give customers in the One-Square Mile Area an
- 26          adjustment for their rates for the inadequate service they have received over the past
- 27          months;
- 28          • Include a provision to allow for variances of the moratorium under appropriate

1 circumstances as recommended by Abbryon, which would allow entities to bring a  
2 new water source to the system. If the Commission approves a variance to the  
3 moratorium that is similar to the one in the Pine Water Company matter, the number  
4 used in residential subdivisions would be 1.2 gpm per lot.

5 28. Staff's recommendations in Findings of Fact No. 27, including the possibility of the  
6 appointment of an interim manager for failure to meet the time deadlines, and with the inclusion of  
7 customers living near, but outside the one-square mile area who can document service interruptions  
8 in the refund/credit requirement, are reasonable and will be adopted.

9 29. Staff recommended that the Commission impose penalties pursuant to A.R.S. § 40-  
10 425 for its violations of Arizona law, statutes, and regulations.

11 30. Due to the serious and ongoing issues concerning water supply and service to  
12 customers, find that a financial penalty should be imposed upon the Company for its violations of its  
13 public service obligations, Arizona law, statutes, and Commission regulations.

14 31. We agree with Staff that a sliding scale of penalties is appropriate and that an  
15 immediate fine of \$50,000 should be imposed. Further, we find that \$50,000 fine should be reduced  
16 by \$2,000 for each day the Cloud Road Booster Station is operational prior to September 29, 2006;  
17 that the penalty for not complying with the December 31, 2006 deadline should be \$200,000; and that  
18 the fine for not complying with the April 1, 2007 deadline should be \$250,000.

19 32. Abbryon presented testimony of its hydrologist who testified that Abbryon proposes to  
20 add a new service well and tank to the Desert Hills system that would support the Cielo Grande  
21 subdivision and also add excess production to the system.

22 33. Abbryon proposed that the Commission adopt a variance mechanism similar to that  
23 the Commission adopted in Decision No. 65435 for the Pine Water Company.

24 34. The Company and Staff agreed that such a variance mechanism is appropriate as long  
25 as the amount of water was proven by a pump test that was acceptable to the Department of Water  
26 Resources.

27 35. We find that a variance mechanism as recommended by the parties using a 1.2 gpm  
28 per REU is appropriate, and that DHW should submit such a written procedure for Staff review and

1 approval.

2 36. No party has proposed that appointment of an interim manager is necessary at the  
3 present time, and we find that no need currently exists to appoint one. It was

4  
5 **CONCLUSIONS OF LAW**

6 1. The Commission has jurisdiction to hear complaints against public service  
7 corporations pursuant to A.R.S. § 40-246, and has jurisdiction to supervise and regulate public  
8 service corporations pursuant to Article XV of the Arizona Constitution and Title 40 of the Arizona  
9 Revised Statutes.

10 2. Desert Hills Water Company, Inc. is a public service corporation as defined in Article  
11 XV of the Arizona Constitution and A.R.S. §§ 40-281, 40-282, 40-202, 40-203, 40-301, 40-302, 40-  
12 303, 40-321, 40-322, and 40-331.

13 3. The Commission has jurisdiction over Desert Hills Water Company, Inc. and the  
14 subject matter of this proceeding.

15 4. Notice of this matter was given in accordance with law.

16 5. The public health, safety, and welfare require the issuance of this order.

17 6. Desert Hills Water Company, Inc. has violated A.R.S. §§ 40-321(a) & (b); A.A.C.  
18 R14-2-407(A); R-14-2-406(J); R14-2-407(C); R14-2-411(A)(2); R14-2-406(B)(2); and its obligations  
19 as a public service corporation.

20 7. Pursuant to A.R.S. § 40-425, Desert Hills Water Company, Inc. should be assessed a  
21 fine of up to \$500,000 as discussed herein, with the possibility of reduction of the fine amount upon  
22 meeting the conditions contained herein.

23 8. The appointment of an interim operator is not necessary to protect the health, welfare,  
24 or safety of Desert Hills Water Company's customers at the present time.

25 **ORDER**

26 IT IS THEREFORE ORDERED that for the violation of Arizona statutes and regulations, and  
27 for failure to meet its obligations as a public service corporation, Desert Hills Water Company, Inc.  
28 shall pay a monetary penalty of up to \$500,000 as set forth herein.

1 IT IS FURTHER ORDERED that Desert Hills Water Company, Inc. shall pay a fine in the  
2 amount of \$50,000 (fifty thousand dollars) payable either by check or money order payable to the  
3 "State of Arizona", and presented to the Arizona Corporation Commission for deposit into the  
4 general fund for the State of Arizona, within 60 days of the date of this Decision.

5 IT IS FURTHER ORDERED that the \$50,000 fine shall be reduced by \$2,000 for each day  
6 that Commission Staff can verify that the Cloud Road Booster Station was operational before  
7 September 29, 2006.

8 IT IS FURTHER ORDERED that in the event that Desert Hills Water Company, Inc. fails to  
9 meet the time deadline for Maricopa County compliance of December 31, 2006, it shall pay a fine in  
10 the amount of \$200,000 (two hundred thousand dollars) payable either by check or money order  
11 payable to the "State of Arizona", and presented to the Arizona Corporation Commission for deposit  
12 into the general fund for the State of Arizona, no later than March 1, 2007.

13 IT IS FURTHER ORDERED that in the event that Desert Hills Water Company, Inc. fails to  
14 demonstrate adequate long-term permanent water supplies by April 1, 2007, it shall pay a fine in the  
15 amount of \$250,000 (two hundred fifty thousand dollars) payable either by check or money order  
16 payable to the "State of Arizona", and presented to the Arizona Corporation Commission for deposit  
17 into the general fund for the State of Arizona, no later than June 1, 2007.

18 IT IS FURTHER ORDERED that in the event that Desert Hills Water Company, Inc. fails to  
19 meet either the December 31, 2006 or the April 1, 2007 deadline, the Commission may determine  
20 that appointment of an interim manager is appropriate.

21 IT IS FURTHER ORDERED that a moratorium is imposed on new hook-ups in the  
22 certificated area of Desert Hill Water Company, Inc. consistent with the discussion herein.

23 IT IS FURTHER ORDERED that a variance mechanism to the moratorium is established  
24 consistent with the discussion herein.

25 IT IS FURTHER ORDERED that Desert Hills Water Company, Inc. shall file with Docket  
26 Control as a compliance item in this docket, its moratorium and its variance mechanism, as well as its  
27 customer notice, for Staff review and approval, no later than 30 days from the date of this Decision.

28 IT IS FURTHER ORDERED that within 45 days of the date of this Decision, Desert Hills

1 Water Company, Inc. shall credit/refund the monthly minimum charges for water service paid by  
2 customers who experienced service interruptions from June 2006 until the Cloud Road Booster  
3 Station is operational.

4 IT IS FURTHER ORDERED that Desert Hills Water Company, Inc. shall file documentation  
5 with Docket Control as a compliance item in this docket, that it complied with the credit/refund  
6 requirement, within 60 days of the date of this Decision.

7 IT IS FURTHER ORDERED that Desert Hills Water Company, Inc. shall file with Docket  
8 Control, as a compliance item in this docket, within 60 days of this Decision in this matter, a detailed  
9 remedial plan as recommended by Staff and adopted herein.

10 IT IS FURTHER ORDERED that Desert Hills Water Company, Inc. shall have a web-site up  
11 and operational for its customers as recommended by Staff by the end of October, 2006.

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1 IT IS FURTHER ORDERED that Desert Hills Water Company, Inc. shall comply with all  
2 Arizona Corporation Commission rules, orders, Decisions, and all applicable state laws and  
3 Constitution.

4 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

5 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.  
6  
7

8 CHAIRMAN

COMMISSIONER

9  
10 COMMISSIONER

COMMISSIONER

COMMISSIONER

11  
12 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive  
13 Director of the Arizona Corporation Commission, have  
14 hereunto set my hand and caused the official seal of the  
15 Commission to be affixed at the Capitol, in the City of Phoenix,  
16 this \_\_\_\_ day of \_\_\_\_\_, 2006.

17  
18 BRIAN C. McNEIL  
19 EXECUTIVE DIRECTOR

20 DISSENT \_\_\_\_\_

21  
22 DISSENT \_\_\_\_\_  
23  
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26  
27  
28



- 1 SERVICE LIST FOR: DESERT HILLS WATER COMPANY, INC.
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